No. 10171

In the United States Circuit Court of Appeals for the Ninth Circuit

ELIZABETH H. FISHER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The opinion of the Board of Tax Appeals (R. 25-37) is reported in 45 B. T. A. 958.

JURISDICTION

This review involves gift tax for 1937. (R. 52–53.) The Commissioner's deficiency letter to the taxpayer was issued February 25, 1939 (R. 12–13), and a petition to the Board of Tax Appeals was filed by the taxpayer May 20, 1939 (R. 1), which was within the period allowed by Section 272 (a) (1) of the Internal Revenue Code. This review is taken from the Board's decision entered February 18, 1942, allowing a deficiency for 1937 in the amount of $2,283.28. (R. 37.) The petition for review by this Court was filed May 7, 1942 (R. 52–55), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether, in creating a trust for the benefit of her grandchildren, the taxpayer made gifts of future interests to the extent of the gifts of the trust corpus and so is not entitled to any $5,000 exclusions under Section 504 of the Revenue Act of 1932.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 501. IMPOSITION OF TAX
>
> (a) For the calendar year 1932 and each calendar year thereafter a tax, computed as provided in section 502, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift.
>
> * * * * *
>
> SEC. 504. NET GIFTS.
>
> * * * * *
>
> (b) *Gifts Less Than $5,000.*—In the case of gifts (other than of future interests in property) made to any person by the donor during the calendar year, the first $5,000 of such gifts to such person shall not, for the purposes of subsection (a), be included in the total amount of gifts made during such year.

Treasury Regulations 79 (1936 Ed.):

> ART. 11. *Future interests in property.*—No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the calendar year. "Future interests" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not

> supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time. * * *

STATEMENT

The pertinent facts, as found by the Board of Tax Appeals, are as follows (R. 27–32):

The taxpayer, a resident of Los Angeles, California, created a trust on September 9, 1937, for the benefit of her six grandchildren and delivered to the trustee bonds of an agreed fair market value of $29,662.49. The trusts were declared irrevocable and the taxpayer assigned to the trustee all of her right, title and interest in and to the bonds. (R. 27, 29.)

The trust indenture provided in part as follows (R. 29–31):

> Second: The Trustee shall from the gross income received from said Trust Estate pay all taxes that may accrue against the Trust property or the income arising therefrom and all proper and necessary expenses of said Trust and the management thereof.
>
> Third: The net income arising from said Trust Estate shall be disposed of by the Trustee as follows:
>
> On or about the 20th day of December of each year the net income accumulated during said year up to the said time shall be distributed to the beneficiaries who have attained the age of twenty-one (21) years, and if under twenty-one years then to the herein designated parent of such beneficiary for his or her use and benefit, in proportion to the share of each therein as herein provided until he or she reaches the age of

twenty-five (25) years, at which time his or her share in the corpus of said Trust fund, together with any accumulated and undistributed income therefrom shall be delivered to the beneficiary arriving at such age free and clear of any control by the Trustee as his or her own property.

Fourth: The beneficiaries of this Trust are:

Dana B. Fisher and Wayne H. Fisher, Jr., sons of Wayne H. Fisher;

Robert F. Oxnam, Philip H. Oxnam and Betty Ruth Oxnam, children of Ruth Fisher Oxnam; and

Richard A. Yerge, son of Rachael Fisher Fayram.

Fifth: As to each beneficiary this Trust, subject to the provisions in paragraph "Sixth" thereof shall continue until he or she shall have attained the age of twenty-five (25) years, whereupon this Trust, as to such beneficiary so attaining said age, shall cease and determine and his share of the corpus of the Trust Estate, to-wit, one-sixth (1/6th) thereof together with one-sixth (1/6) of any accumulated or undistributed income which may be in the hands of the Trustee at such time, shall go to and be delivered to such beneficiary so attaining the age of twenty-five (25) years.

Sixth: Should either or any of said beneficiaries named in this Trust die prior to the termination of said Trust as to him or her, leaving issue, then the corpus and income that such deceased beneficiary would have received had such beneficiary lived, shall go to and vest in the issue of said deceased beneficiary by right of representation and as to whom said Trust shall be deemed terminated by his or her death; and

> should either or any of said beneficiaries die prior to the termination of this Trust, as to him or her, without issue, then the share or interest that such beneficiary would have received, if living, shall go to and vest in equal shares in the surviving beneficiaries and to the children of any deceased beneficiary, if any, by right of representation.

It was also expressly provided in the trust agreement that none of the beneficiaries was to have any right to alienate any part of the income or corpus of the trust. (R. 31.)

In her gift tax return for 1937 the taxpayer, proceeding on the theory that six gifts were made through the trust agreement and that she was entitled to six exclusions not exceeding in the aggregate $29,662.49, did not include such sum in the total of the gifts made. The Commissioner determined that there was but one gift, the gift to the trust, and that the taxpayer was entitled to but one exclusion of $5,000. By his amended answer the Commissioner claimed that he erred in his allowance of the exclusion of $5,000 upon the ground that the gifts in trust were gifts of future interests, and accordingly asked for an increase in the deficiency arising from such alleged error. (R. 31–32.)

The Board rejected the Commissioner's determination in part by holding that the taxpayer made gifts of a present interest in the income of the trust, the value of each gift being the present worth of the right to receive one-sixth of the income of the trust fund during the period it was payable to the donee. But the Board approved the Commissioner's determination as

to the gifts of the remaining interests and so held that the gifts of the corpus of the trust were gifts of future interests. Accordingly, it decided that there is a deficiency for 1937 in gift tax of $2,283.28. (R. 34–37.)

SUMMARY OF ARGUMENT

The Board correctly held that the gifts of the corpus of the trust were of future interests and so cannot be excluded in the computation of the gift tax due from the taxpayer. The beneficiary of a trust is to be treated as the donee and the nature of the gift is to be determined by what such beneficiary receives. If the trust limits the gift by providing that the beneficiary's use, possession or enjoyment of the thing given is to commence at some future date or is contingent upon the happening of an uncertain event in the future, the gift is one of future interest. As the facts here show that so far as the gifts of the corpus are concerned, the gifts would not take effect until each beneficiary reached the age of twenty-five and not then if the beneficiary was not living, such gifts are clearly of future interests.

ARGUMENT

The Board correctly held that the gifts of trust were of future interests and that no exclusion in respect thereto is allowable

In computing gift tax, a taxpayer is allowed by Section 504 (b) of the Revenue Act of 1932, *supra,* to exclude up to $5,000 of gifts made to any donee in a year unless the gifts are of future interests in property. After several conflicting decisions of lower courts as to who should be considered the donee in case of gifts in

trust, the Supreme Court held in *Helvering* v. *Hutchings,* 312 U. S. 393, that the beneficiary, not the trustee, is the donee under the above section. It also held in *United States* v. *Pelzer,* 312 U. S. 399, that in determining the nature of gifts in trust it was not required to follow any local law in defining "future interests" and decided that the gifts there involved were of future interests because the beneficiaries had no right to the present enjoyment of the corpus of the trust or of the income. In reaching this conclusion the Court approved Article 11 of Regulations 79, *supra,* which is involved here and which states that,

> "Future interests" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time.

In these cases, the Supreme Court did not find it necessary to decide whether gifts of trust income, currently distributable, are gifts of present or future interests.[1] But in the instant case, the Board decided that the gifts of trust income are of present interests, and we do not contend otherwise. The Board allowed exclusions for the value of these present interests, which in each instance was considerably less than

[1] As to this see *Commissioner* v. *Gardner*, *supra; Helvering* v. *Blair*, 121 F. 2d 945 (C. C. A. 2d); and dissenting opinion in *Rheinstrom* v. *Commissioner*, 105 F. 2d 642 (C. C. A. 8th). Attention is also called to the fact that in case of gifts made after 1938, no exclusions are allowable if the gift is in trust. Section 1003, Internal Revenue Code.

$5,000, but allowed no exclusions as to the rest of the gift. We submit that the Board's holding that the gifts of corpus are gifts of future interests is correct and is in accord with the *Pelzer* case. As indicated in that case, as well as in the *Hutchings* case, we are now required (after a period of several conflicting decisions) to look to the interest which the trust instrument gives the beneficiary in order to determine whether he has received a gift of present or future interest. *Commissioner* v. *Gardner,* 127 F. 2d 929 (C. C. A. 7th); *Commissioner* v. *Brandegee,* 123 F. 2d 58 (C. C. A. 1st). If it is found that the enjoyment, use, or possession of the interest which has been given must be postponed until some future time whether definitely set or dependent upon an uncertain event, it must be concluded that the gift is of a future interest. *Commissioner* v. *Boeing,* 123 F. 2d 86 (C. C. A. 9th); *Welch* v. *Paine,* 120 F. 2d 141 (C. C. A. 1st); *Commissioner* v. *Glos,* 123 F. 2d 548 (C. C. A. 7th). The gifts of corpus were gifts of this character and so it has been correctly held that no exclusions are allowable as to them.

In contending otherwise, the taxpayer argues in substance that there was only one gift to each beneficiary and that it must be treated as a gift of a present interest because the gift of income was a present interest and the same gift cannot involve both a present interest and a future interest. (Br. 19.) We submit that the taxpayer is in error whether we take the view that each beneficiary received two gifts or one gift. Certainly the trust agreement sets out two distinct kinds of interests which were given to the beneficiaries and we prefer

to speak of them as two kinds of gifts, namely (1) the gifts of the net income of the trust estate to be distributed among the named beneficiaries on December 20th of each year until each reached the age of twenty-five (R. 29) and (2) gifts of the trust corpus to be distributed to the same beneficiaries upon reaching the age of twenty-five, but if any should die prior to that time, his share is to be paid to his issue, if any, and if there is no issue, then to the other beneficiaries (R. 30–31). Thus it is clear that of the two separate interests which each beneficiary got only the first can be classified as a present interest. Whether there is one gift or two it is necessary to value the present interest as distinguished from the future interest since the statute allows an exclusion only in regard to the former. Article 11 of Treasury Regulations 79, *supra,* also prohibits the exclusion of any part of the value of a future interest, and this is what the Board has done here.

Moreover, it is not significant, as the taxpayer appears to think, that the second group of gifts was made to the same beneficiaries as the first group. Indeed it frequently happens that a beneficiary may receive different kinds of interests and each may pertain to the same piece of property. Sometimes, as in the *Pelzer* case, these different interests may all be future interests, but there is no reason why a gift of a present interest and of a future interest may not be made as here, and the fact that both pertain to the same property does not merge the gifts into one of a present interest. If the trust had provided for a gift of income to A for a term of years to be distributed currently

and a gift at the end of such term of the trust corpus to B, the latter would certainly be a gift of a future interest. See *Commissioner* v. *Brandegee, supra,* at page 62. And the gifts here are essentially the same as that made to B in the hypothetical case.

Two of the cases the taxpayer relies largely on are *Commissioner* v. *Krebs,* 90 F. 2d 880 (C. C. A. 3rd), and *Noyes* v. *Hassett,* 20 F. Supp. 31 (Mass.),[2] but both of these cases applied tests which are no longer approved in gift tax cases and they have been in effect overruled by later cases. At the time the *Krebs* and *Noyes* cases were under consideration the principal issue in cases of this kind was whether the trust or the beneficiary was the donee, and it was held there that the trust was the donee. At that time this issue was approached from the standpoint of what the donor owned and gave away. As the donor creating an irrevocable trust of property owned outright would necessarily transfer a present interest if he parted with his entire interest, it was thought that the present interest must go to the trust as it was the one receiving legal title and in control of the trust fund. Under this theory gifts in trust had to be gifts of present interests. See *Commissioner* v. *Wells,* 88 F. 2d 339 (C. C. A. 7th), which has been specifically overruled by *Commissioner* v. *Gardner, supra.* But as we have indicated above, we are now required to approach the issue here from

[2] The taxpayer also refers to *Paine* v. *Welch,* 42 F. Supp. 348 (Mass.), now pending on the Government's appeal to the Circuit Court of Appeals for the First Circuit and believed to be contrary to decisions of that court cited herein. Moreover, the facts in that case are distinguishable from those here.

the standpoint of the beneficiary. As to this changed viewpoint see *Commissioner* v. *Boeing, supra.*

The taxpayer apparently argues that the fact that beneficiaries here may be taxable on the income distributed currently by the trustee proves that they have a present rather than a future interest in the corpus. The taxpayer is in error in assuming that there is a necessary correlation between the gift tax and income tax. *Estate of Sanford* v. *Commissioner,* 308 U. S. 39, 47. Moreover, any interest in the corpus which went with the right to income was an equitable one, not a legal one, and was only for a limited period. But the gifts of corpus with which we are concerned here are gifts of the entire interest, legal as well as equitable, and are not to be enjoyed, if at all, until each beneficiary becomes twenty-five years of age. The donee's possession and enjoyment of the corpus is necessarily postponed until the termination of the trust and hence is a future interest.

The Board's decision is in accord with *Charles* v. *Hassett,* 43 F. Supp. 432 (Mass.). There the donor gave $5,000 to a trustee to pay the income to A while living and to pay the principal to him, one-third at twenty-five, one-third at thirty and one-third at thirty-five, but if he died before full distribution, then the gift went over to other persons. In answering the question as to what part of the gift, if any, was of a present interest, the court said (pp. 434–435):

> * * * the answer is that historically lawyers have treated gifts of income beginning at once and lasting for life, or for a period of years, as a "present interest" and gifts of principal at a

> future date as a "future interest"; that Congressional committees and the Treasury appear to have had some such distinction in mind; and that this and other circuits in construing the gift tax statute have used that line of distinction in cases where the gifts of income and of principal were to different persons. * * * No historical reason justifies abandoning the distinction in cases where the gifts of income and of principal are to the same person and are therefore regarded by donor and donee as one gift. * * *
>
> On the basis of authority, I conclude that the gifts of corpus here are gifts of "future interests in property" and are subject to the gift tax, and that the gifts of income here are gifts of "present interests" and are excludable up to $5,000 for each beneficiary.

We submit the same conclusion should be reached here.

CONCLUSION

The Board's decision is correct and should be affirmed.

Respectfully submitted.

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